

EXECUTIVE GUIDE

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REVIEW: Legal

The Set Up



► BHM Lansky Ganzger & Partner LLC provides an overview of the rules and regulations for establishing and running a business with foreign capital in Azerbaijan.

With its substantial oil and gas reserves and strategic geographical location Azerbaijan has been and continues to be a target destination for astute foreign investors. Since the country's independence, considerable efforts have been made to attract foreign investors to the domestic oil and gas industry. With this sector now firmly established, attention is being turned to the development of the non-oil sectors. Azerbaijan is receiving increased interest from around the world, with the potential for investment in financial services, infrastructure, consumer goods, construction, telecommunications, IT, tourism, and the education sector.

The legal system of Azerbaijan is based on civil law and the highest judicial authority is the Constitutional Court, which is ultimately overseen by the European Courts. In contrast with the common law-based judicial systems of the US and the UK, the civil law system of Azerbaijan does not rely on case law or judicial precedent. The 1995 constitutional acts adopted via referendum and legislation passed by the Milli Majlis, or Azerbaijani Assembly, are the primary sources of law.

Foreign investors are in general subject to standard Azerbaijani legislation, save for those working in the oil and gas industry who are affected by the numerous Production Sharing Agreements (PSA)

and Host Government Agreements (HGA). At present there are 31 ratified PSAs and HGAs, and each agreement is subject to its own exclusive tax and accountancy regime, with these generally offering more favorable legal and tax regulations for participants, contractors, and sub-contractor parties.

Reforms to Setting Up a Business

In the last decade a number of practical reforms have been made to the legal system to ease the process of doing business. The World Bank Doing Business report for 2009 listed Azerbaijan as a top reformer, with improvements made in seven out of 10 indicators of regulatory reform. In 2004 starting a business involved the application of 13 separate pieces of legislation, registration with six different bodies, following 15 procedures and the completion of over 33 documents; the entire process of which took 106 days.

In 2006 the President declared the situation as “unacceptable” and over the following two years a consultation and research program was initiated with the aim of overhauling the entire process. In 2008 a “one-stop shop” for business registration was implemented, simplifying the procedure and enabling all documents to be filed at a single state body—the Ministry of Taxes. As a result, the entire start-up process of a business can now be completed within 40 days. The results of the implementation of the one-stop shop were immediately visible, with the following six months seeing an increase in business registration of 40%.

In the beginning of 2011 a new act on Administrative Proceedings and Administrative Procedural Code came into force and new specialized administrative courts have begun operation. The aim of the new act is to improve the regulation of admin-

istrative procedures and enhance human rights in the country. New courts have been established in a number of regions and judges are receiving training on the new procedures. The legislation will improve access to effective dispute resolution mechanisms between citizens and public officials.

A significant amount of documents are required to register a company, however, and some documents must bear an apostille from the investor's country of incorporation. Azerbaijan is party to the Hague Convention on Abolishing the Requirement of Legalization for Foreign Public Documents, and as a consequence documents originating from Hague Convention signatory countries do not require legalization (with the exception of a handful of countries).

Conditions for Foreign Investors

The government has an active policy of supporting privately held enterprises, including those owned by foreign companies. Incentives may be available to foreign investors in certain sectors, granted by legislative acts and by agreements directly between the state and investors. The Law on Protection of Foreign Investments of January 15, 1992 sets out the forms foreign investment may take. There are no exclusive rules for the incorporation of companies by foreign investors with the exception of the standard translation and notarization requirements. Foreign investors may acquire domestic enterprises; establish joint venture operations; create enterprises wholly owned by foreign persons/legal entities; and open representative/branch offices. The legislation stipulates that foreign companies may be engaged in any type of economic activity provided it is not prohibited under Azerbaijani law. »

There are a number of guarantees that protect foreign investment. Foreign investors enjoy a “not-less favored” regime, and therefore have the same rights as local investors. There is a guarantee against nationalization, which is only permitted in cases of emergency, and in such cases foreign investors are entitled to prompt and effective compensation. The right exists to repatriate profits, revenues, and other amounts received through investments, provided that all taxes have been paid. If an amendment is made to legislation that adversely affects a foreign investment, that change is subject to a 10-year moratorium. Pursuant to the Azerbaijan Land Code only Azerbaijani citizens and legal entities can own land; however, foreign individuals and entities can lease land and own immovable property, such as apartments and houses.

Azerbaijan has entered into 39 bilateral investment treaties on the mutual protection of investments, with several more treaties being negotiated, and is also party to a number of multilateral treaties concerning foreign investment.

Establishing a Legal Presence

The Azerbaijan Civil Code and the Law on State Registration and the State Register of Legal Entities set out the regulations for establishing a legal presence in Azerbaijan.

Joint Stock Company (JSC)

A JSC may be founded by either an individual or legal entity and may be either open or closed, with the closed JSC being limited to a maximum number of 50 shareholders. The charter capital of a JSC is made up of a fixed number of shares and the minimum amount of charter capital is AZN2,000 for a closed JSC and AZN4,000 for an open JSC. Capital contributions made “in kind” (e.g. property or supplies) must be independently valued and resolved at the founders meeting.

The foundation agreement and charter of the JSC are adopted at the founders meeting. The charter capital must be paid in full prior to state registration. Following that the JSC and the issued shares must be registered, the issued shares must be placed, and a report on the results of the placement must be registered. Issued shares are investment securities and must be registered at the State Securities Committee. The shares of an open JSC must be made publicly offered and this may be conducted by the JSC itself or through a stock exchange.

JSC shareholders/participants cannot be held to be personally liable for the li-

abilities of the company and are liable for the obligations of the JSC only to the extent of their capital contribution. Shares of a closed JSC are distributed among the shareholders and may be transferred to third parties only upon the shareholders right of first refusal being exercised or upon the JSC’s failure to purchase the shares. A shareholder has one month to decline to exercise the right to purchase the shares. The General Meeting of Shareholders (GMS) has exclusive competence in decision-making activities relating to the JSC and must be held not less than once a year. Open JSCs must publish notice of both annual and extraordinary General Meetings of Shareholders in the official press at least 45 days before a meeting.

An open JSC must establish a Supervisory Board of Directors to monitor the activity of the company’s executive body. The supervisory board may be made up of shareholders or external persons and its directors may not be members of the company’s executive management body. An open JSC must also appoint an internal auditor to monitor the company’s finance operations, and an audit must be conducted at the end of each financial year.

The executive management body of a JSC may be made up of a board of managers or by a sole manager and is responsible for day-to-day management duties.

Limited Liability Company (LLC) & Additional Liability Company (ALC)

An LLC can be created by one or more individuals and/or legal entities contributing their participatory interest to the charter capital. If the LLC is made up of only one legal entity, then that legal entity may not be a company having only one participant/shareholder. The participants in an LLC are normally liable only to the extent of their contributions and are not liable for the LLC’s obligations. In turn, the LLC is not responsible for the obligations of its participants to third parties. A participant may sell an interest to a third party, but the other participants have the right of first refusal, unless the charter provides for otherwise.

There is no specified minimum capital requirement, although the Civil Code states that the minimum capital is to be set by the relevant executive authorities. The charter capital contributions of the participants must be paid in full prior to state registration. Capital contributions in kind must be valued by an independent auditor.

The General Meeting of Partners (GMP) must be held a minimum of once annually and a GMP dealing with the results of an annual activity must be held no later than

four months after the end of the reporting year. The establishment of a Supervisory Board of Directors is optional, but if one exists its directors cannot be on the executive management body.

The structure of an ALC is similar to that of an LLC with the distinction that participants in an ALC may assume liability for the company in excess of their contributions.

Partnerships

There are two types of partnership operations in Azerbaijan: a General Partnership and a Limited Partnership. A General Partnership must be made up of at least two sole proprietors and/or legal entities and the partners may only be participants in one partnership, either general or limited. A Limited Partnership comprises of at least one or more General Partner and one or more Limited Partners (who may be either individuals or legal entities) and as in a General Partnership, partners cannot participate in more than one partnership. General Partners are jointly and severally liable for the partnership’s liabilities and the partners are personally liable for such obligations that the partnership has insufficient assets to fulfill. In a Limited Partnership, a Limited Partner is liable only to the extent of their contributions, while a General Partner is personally liable for the partnerships obligations.

Partners may withdraw from a partnership by giving six months notice to the other partners and are entitled to retrieve the value of their participatory interest. General Partners remain liable for the debts acquired by their partnership before their departure for a period of two years.

Non-commercial Organizations

Whilst not-for-profit organizations may be established for social and economic activities not related to the generation of profit, they are treated as legal entities in Azerbaijan and have most of the corresponding rights and obligations. Non-commercial organizations are registered with the Ministry of Justice, and a recent change to the legislation now requires applicants to enter into an “agreement” with the Ministry, setting out the conditions under which the organization must agree to operate. The main conditions are that the organization must not engage in any illegal acts or political propaganda.

Branch / Representative Offices & Subsidiaries

Branch and representative offices of foreign companies are not considered legal entities under Azerbaijani legislation. Both branch

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and representative offices have “non-resident” status in respect of tax, legal, and currency regulations. They are free of the requirement to have a charter fund and are able to remit income to overseas accounts, provided that the latter are registered with the Azerbaijani authorities. Whilst such offices are not subject to any profit tax (provided the activities of the office are strictly restricted to representing the head office), they must make timely payment of all other applicable taxes to the authorities, in particular personal income tax and social fund payments from employees.

A subsidiary of a foreign company in Azerbaijan is considered a legal entity and as such should be established as one of the prescribed legal entity forms. The subsidiary may be wholly held under foreign ownership, but is considered a resident legal entity for tax, currency accounting, reporting, and other requirements.

Acquisition of a Local Business

Acquisitions concerning Azerbaijani businesses are subject to a number of corporate, anti-monopoly, and other prior governmental approvals, registrations, and statutory requirements imposed by the Civil Code, privatization laws and regulations, and certain industry-specific laws.

In an acquisition of shares the purchaser assumes the liabilities of the target company and the Civil Code requires notice of 21 days to be served on all creditors of the target company. An acquisition of shares in an LLC is not required to be approved by the target company’s GMP; however, the charter of a company must be updated following a change in ownership. Therefore, a share acquisition involving an LLC is indirectly subject to approval at a GMP. An acquisition of shares in a JSC that exceeds 25% of the net assets of the company must be approved at a GMS. Although it is not a requirement that the JSC itself be a party to a share acquisition contract, in practice the JSC usually is party to the agreement.

Acquisitions of shares in certain industries require state notification or approval.

The Law on Banks regulates the acquisition of shares in banks and requires notification to the Central Bank of any proposed transfer of shares that results in a new shareholder having “significant ownership”. This is defined as being at least 10% of the bank’s charter capital or as having sufficient share capital to result in control over the bank’s decision-making process. If company assets being acquired belong to an Azerbaijani bank and have a value of over 50% of the company’s charter capital the Supervisory Board must approve the purchase.

The laws concerning anti-monopoly require that prior approval be sought in certain situations where the acquisition results in an interest of more than 20%, specifically when: i) the acquisition results in control of the company, ii) any of the companies involved in the deal have a more than 35% market share, or iii) the combined assets of the companies involved is greater than 75,000 conditional financial units. Consent is also required to acquire assets from a natural monopoly, such as a utility provider, with a value greater than 10% of the charter capital of the company. Amendments to a company’s charter must be registered with the Ministry of Taxes for any acquisition to have legal effect. Similarly, if an asset acquisition involves immovable property the rights must be registered with the State Register of Immovable Property. Certain securities based on movable assets must be registered with the State Securities Committee.

Licensing

The Azerbaijani licensing system was reformed in 2002 to reduce the number of business activities requiring licenses from 200 to 57. Among the remaining commercial activities that require licenses are the sale of oil and gas products, the operation of communication services, engineering works, banking activity, tourism operations, and many more. The Central Bank of Azerbaijan has the exclusive right to grant banking licenses. The Ministry of Economic Development exercises overall control over the issuance of licenses, with a number of specific state ministries being responsible for issuing relevant licenses. Following the submission of all required documents a license will be issued within 15 days, and in most cases will be valid for a term of five years. State duties for licenses can be up to AZN22,000. Penalties for operating without a required license are severe and will be imposed pursuant to the Code on Administrative Offences and the Criminal Code.

Custom Regulations

Azerbaijan is not currently a member of the WTO, although it is in discussions to join. The country recognizes a number of custom regimes for imported goods, in particular transit, customs storage, bonded warehouse, temporary import and processing in and outside customs territories. Goods imported into Azerbaijan are subject to import duties ranging from 0% to 15% per metric unit. Excise tax applies to certain goods, notably tobacco and alcohol products. VAT is payable on the declared value of the goods, although certain categories are exempt from import duties and VAT. Exports are in general exempt from customs duties, save for certain types of metal products. A customs clearance fee of AZN550 is payable on most imports/exports.

Labor Law Regulations

Labor matters are regulated by the Labor Code 1999 as amended, together with a number of other laws and regulations issued pursuant to the Labor Code. The working week is 40 hours and the minimum amount of paid annual leave is 21 days, with certain senior professionals entitled to 30 days. In addition, there are 18 non-working days. An employer must give an employee two month’s notice if it wishes to terminate the employment contract and the employee must give one month’s notice. Termination of certain categories of employees is prohibited, including pregnant women and women with children under three years of age. The retirement age for women is 58 and for men is 63.

Foreign nationals wishing to work in Azerbaijan must obtain a work permit, which requires being registered at a place of residence. Work permits can be issued for up to one year and may be renewed up to four times. Heads of representative and branch offices are not required to obtain a work permit. ●

The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.

TBY would like to thank BHM Lansky Ganzger & Partner LLC for compiling this analysis.



INTERVIEW

Anar Baghirov



The Lay of the Land

TBY talks to *Anar Baghirov*, Managing Partner of **BHM Baku Law Center**, on Azerbaijan's business legal climate.

TBY What should foreign companies be aware of before engaging in their start-up phase?

ANAR BAGHIROV The Azerbaijani government welcomes foreign investors and considers foreign investment to be important for the development of the national economy. Therefore, continuous improvements are being made to the legislation in order to attract more and more investors. In order to be successful in engaging local markets, one should first become familiar with the culture and tradition of the regions. This is a great opportunity for investors to not only do business, but also to expand their knowledge of a variety of cultures around the world, making it easier for them to understand individuals from different backgrounds. Moreover, from the very start, investors should be set on targeting markets on a continuous basis, as well as making new contacts and even more friends. Local partners can also offer a great deal of assistance. This makes processes run more smoothly, enabling investors to achieve their goals in a shorter timeframe. Investors should be aware that although the oil and gas industry is the field attracting most foreign investment, Azerbaijan's economic strategy is to develop the other fields of economy. Thus, foreign companies should view investing in

other production or service industries as good opportunities that will also be welcomed and protected by the government. Azerbaijan has concluded numerous bilateral investment treaties and is a party to several multilateral treaties that should give more assurance to foreign investors from countries that are also parties to those treaties. The fact that Azerbaijan is a party to the Washington Convention on the Settlement of Investment Disputes between nations and nationals of other nations means that investors can have any disputes between them and the state settled by ICSID arbitration, which is a neutral forum. Foreign investors should note that Azerbaijan is not a member of the WTO, although accession negotiations are ongoing and Azerbaijan is gradually improving its legislation in accordance with WTO norms and standards.

What regulation changes are we likely to see over the medium term aimed at making life easier for foreign investors and start-up companies?

Azerbaijan is continuously developing its legal framework in order to create better and easier conditions for foreign investors to do business in Azerbaijan. Older laws are being simplified and modernized, taking into account international practice and the recommendations of international organizations. In early 2011 a new act on Administrative Proceeding and Administrative Procedural Code came into force. This provides a new legislative base from which the judiciary will conduct administrative activities, and judges are now receiving training on the new legislation. The act aims to improve human rights in the country. In the near future the adoption of new important codes such as the Construction Code and the Competition Code is expected. These Codes will unify, harmonize, and simplify the numerous laws and regulations governing these issues. Also, a new draft of the Customs Code will replace the current one. Besides creating more favorable conditions and simplifying the registration and declaration rules, the new Customs Code is expected to foster modernization of the customs infrastructure in conformity with international standards and accelerate Azerbaijan's membership to the WTO. Apart from these major codification changes, various laws and regulations are going to be amended in order to make business easier for foreign investors. ●

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EDUCATION

LLB in Civil Law, Baku State University
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CAREER OVERVIEW

Anar Baghirov worked as a lawyer for the Azerbaijan Culture Foundation from 1997 to 2000. He then became Senior Legal advisor for Tpet Oil & Gas Co Ltd before making Partner at BHM Baku Law Center. His main practice areas are contract law, corporate law, and intellectual property law. Mr. Baghirov has been a member of the Azerbaijan Bar Association since 2005 and was awarded with the Certificate of Honor by the Association in 2008. He is a member of the Azerbaijan Bar Association, Judge Selection Committee, and the editorial board of the *Southern Caucasus Law Journal*. He has been identified as one of the leading lawyers in the CIS by *Who's Who Legal 2011*.

INTERVIEW

Gabriel Lansky



Austrian Additive

TBY talks to *Gabriel Lansky*, Managing Partner of **Lansky Ganzger & Partner**, on Austrian penetration of the local market and the legal potential for foreign investment in Azerbaijan.

TBY How many Austrian companies conduct business in Azerbaijan and what are the main areas of their activity?

GABRIEL LANSKY Presently over 30 Austrian corporations conduct frequent business in Azerbaijan in various fields including construction, tourism, and energy. These companies include established names on the Austrian business market such as OMV, Strabag, Doppelmayr, and Coop-Himmelblau. LGP, along with OMV, ASP Consulting, Siemens, and Coop-Himmelblau founded the Austrian-Azerbaijani Chamber of Commerce, which is dedicated to improving business and cultural relations between Austria and Azerbaijan, increasing export-import operations between the two nations, and attracting further Austrian and Azerbaijani companies to enter both markets.

Could you tell us about your first experience with Azerbaijan?

We have been working on legal projects with clients from Azerbaijan for several years and are proud to say that our firm was one of the first Austrian companies to enter the Azerbaijani market. Beginning initially with the smaller-scale legal cases of private companies from Azerbaijan, we expanded to representing the interests of Azerbaijani clients before the European Court of Human Rights.

Why did a joint venture operation appeal to you above other modes of establishing a presence in the country?

In general, it is not easy for a law firm to position itself internationally, primarily as different regions require different business models. One cannot simply employ the same strategy in the enormous markets of Russia or China as in the smaller, network-oriented markets of Azerbaijan. We established a joint venture as we felt that current traditional models are simply sub-par for our clients. Our competitors who operate internationally do so mainly on the basis of a sort of franchise system in which they collaborate with local lawyers under the name of a Western law firm. The most successful local firms, however, are usually well established in their domestic markets and are not inclined to work under a foreign name. Meanwhile, smaller firms operate internationally with loose networks. This does not necessarily make for an ideal solution based on international standards, and consequently we developed a new strategy. Depending on the size of the target market, we maintain different numbers of qualified "best-friend firms", combining this site model with the activities of legal experts in the target markets with our main offices in Vienna and Bratislava. As with BHM, these legal experts not only know every aspect of their domestic markets, but also coordinate collaboration with the appropriate partners for each project and guarantee the necessary quality assurance. Our joint venture became the very first project of its kind in Azerbaijan and the model is a unique solution combining the services of the deep-rooted international experience of LGP with successful local firm BHM.

Could you highlight any specific foreign investment success stories in which your firm has been involved?

We offer valuable assistance to foreign companies entering the market and are committed to the continued success of the region as a destination for FDI. We have assisted several companies in quickly registering their branch offices in Baku and also providing them with all necessary legal backing and market consultancy services. Today these companies are operating in Azerbaijan successfully with our ongoing cooperation. As I mentioned before we have also established the Austrian-Azerbaijani Chamber of Commerce (ATAZ), which has now attracted numerous members and aims to further strengthen business relationships in the country. ●

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EDUCATION

Faculty of Law and Political Science, University of Law, Economics and Sciences of Aix-Marseille
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CAREER OVERVIEW

Mr. Lansky passed the Bar in 1985 and was made partner at Rudolf Müller & Partners in the same year. In 1991, he formed his own law firm and formed the partnership Lansky & Prochaska in 1997. The company merged with law firms Dr. Elisabeth Steiner in 2001 and Dr. Gerald Ganzger in 2004. He became a member of the Brussels Bar in 1997, and the Budapest and Bratislava Bars in 2004.